

Economics in Brief



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Japan: “Abenomics” – a success story?

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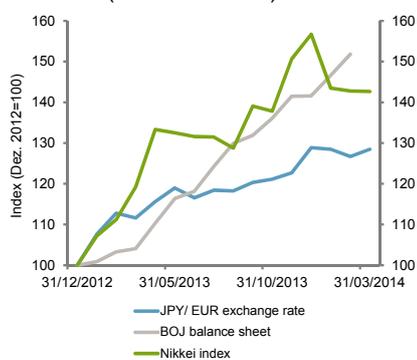
In early 2013, the newly formed Japanese government announced “Abenomics”: In addition to new fiscal stimulus measures and structural reforms (e. g. deregulation in the services sector and labour market reforms), “Abenomics” centres around a substantial easing of monetary policy with the aim of raising expected and actual inflation rates as well as exercising a dampening effect on the external value of the yen.

“Abenomics” has fuelled financial markets ...

The results achieved so far have been mixed: A large proportion of the structural reforms have yet to be implemented. Compared to previous episodes, fiscal stimulus has been small. The increase in VAT is now counteracting it.

The centerpiece of “Abenomics” is the aggressive policy of the Bank of Japan (BOJ). Since December 2012, total assets of the central bank have increased by more than 50%: An even stronger monetary expansion is in the offing.

Figure 1: BOJ balance sheet and financial market indicators
(Dec. 2012=100)



Source: Bloomberg

As a consequence the yen has depreciated considerably (by almost 30% against the Euro in nominal terms) and the inflation rate has picked up to 1.5% yoy (February 2014). The equity markets have particularly

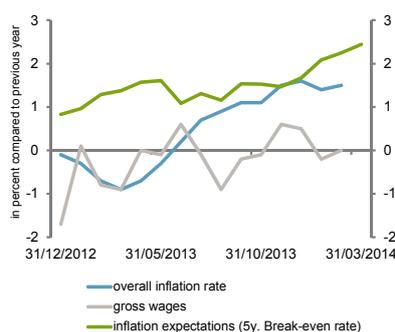
embraced “Abenomics”. In March 2014, the Nikkei index was trading around 40% higher than in December 2012.

... and (at least temporarily) boosted growth and inflation

“Abenomics” has resulted in a marked improvement in business sentiment. This optimism, however, has only partly been reflected in “hard” economic data. In 2013, real GDP growth amounted to 1.5% yoy thus barely exceeding previous year’s increase (1.4%). The stimulating effect from the rise in public investment (2013: +12% yoy) began to fade away already in the second half of the year. The small increase in real exports (2013: +1.6% yoy) indicates that yen depreciation primarily bolstered the earnings of export companies and not their market shares. This justifies the positive stock market sentiment, but it does not increase growth.

Initial successes have been achieved on the deflation front, as both actual inflation rates and inflation expectations have risen. Despite all measurement problems, this is important for the future. So far, the increase in inflation towards the 2 percent target rate has, however, primarily been the result of the depreciation-induced rise in import prices (+14.4% in 2013 compared to -0.2% in 2012).

Figure 2: Inflation and wages



Sources: Bloomberg, Feri

The wage trend is key to the long-term success of “Abenomics”

The rise in the VAT rate from 5 to 8% this month should push the inflation rate further in the direction of 2%. But this is a one-off effect.

In order to anchor inflation and inflation expectations *permanently* around the 2% mark, moderate but continuous growth in wages and corporate investment is required. Since December 2012, the trend is in the right direction, but the final turnaround has not yet been achieved. During the recent wage negotiations, the government therefore exerted massive pressure on large companies to bump up wages: It did not even shy away from holding out the threat of sanctions. The success of this strategy will to a major part depend on whether the wage increases will also benefit the high number of relatively poorly paid temporary and part-time workers. Many of them work in small domestic oriented companies, which rather tend to suffer from a weaker yen than to profit from it.

In order to trigger a marked increase in private investment a positive outlook for domestic and export businesses as well as clear progress with structural reforms are needed.

Outlook

The greatest achievement of “Abenomics” has been to synchronize Japan’s monetary and fiscal policy. This move has met a positive reception, particularly in financial markets. It has also had the desired dampening effect on the Yen while the business mood of Japanese companies has markedly brightened up. Momentum must now be carried on into the second and third phase to ensure “Abenomics” becomes a long-term success. This will require an appropriate wage policy as well as decisive progress in the area of structural reforms. In addition, Japan must make better use of its workforce potential, not least in view of the progressive ageing of its population. ■